Supreme Court of the United States

OCTOBER TERM, 1940.

MAR 14 1941
CHARLES ELMORE CROPLEY
CLERK

IN THE MATTER

of

DEEP ROCK OIL CORPORATION, a corporation,
Debtor.

No. 846

STANDARD GAS AND ELECTRIC COMPANY, a corporation,
Petitioner,

v.

DEEP ROCK OIL CORPORATION, Debtor, HENRY N. GREIS, Trustee, JOHN J. SHINNERS, NEWTON P. FRYE, ROBERT F. HOLDEN, JOHN H. MASON, ALBERT J. ROBERTSON, and CHARLES S. SARGENT, as a Reorganization Committee, JOHN M. TAYLOR, OSCAR A. KENNEDY, and H. RUSSELL HASTINGS, as Independent Preferred Stockholders Committee.

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PETITION FOR WRITS OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

A. LOUIS FLYNN,
JACOB K. JAVITS,
WILBUR J. HOLLEMAN,
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INDEX

Subject Index

PAGE

PETITION FOR WRITS OF CERTIORARI 1

Introductory Statement 2

Statement of the Matter Involved 3

Questions Presented 7

Reasons for Granting Certiorari 8

Prayer 12

BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI 15

Opinion of Court Below 15

Jurisdiction 16

Questions Presented 16

The Statutes Involved 18

Statement of the Case 18

Specifications of Error 19

Summary of Argument 20

Argument 21

I. Where a debtor is not insolvent, and where provision has been made for the full satisfaction of the prior rights of creditors, leaving only the participation of stockholders to be considered, a plan of reorganization may not be confirmed without the consent of excluded creditors and stockholders, unless payment or protection is provided for such excluded creditors and stockholders in a manner prescribed in Section 216(7) and (8) of the Bankruptcy Act, as amended 21

PAGE

II. Equity requires the reorganization court to take into consideration in the determination of whether the plan is fair and equitable to Standard (under the particular circumstances of this case) (1) the actual prices paid by holders of notes and preferred stock who acquired such securities during the pendency of the reorganization proceedings at discounts below their face value, and (2) the evidence received by the District Court subsequent to the decision by this Court in the *Taylor* case.. 28

Conclusion 33

Exhibit A 35

Table of Cases Cited

PAGE

Campbell v. *Alleghany Corporation,* 75 F. (2d) 947 (C. C. A. 4th, 1935), cert. den. 296 U. S. 581....10, 24
Case v. *Los Angeles Lumber Products Co. Ltd.,* 308 U. S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (1939)..9, 21, 26
In re Consolidated Rock Products Co., —— U. S. —— (October Term, 1940, Nos. 400 and 444)..9, 21, 22, 26

Hamilton-Brown Shoe Co. v. *Wolf Bros. & Co.,* 240 U. S. 251, 36 S. Ct. 269, 60 L. Ed. 629 (1916).... 2

Louisville Jt. Stock L. B. v. *Radford,* 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593 (1935)..... 23
Louisville Trust Co. v. *Louisville, New Albany and Chicago Railway Co.,* 174 U. S. 674, 684..... 9

In re 620 Church Street Bldg. Corp., 299 U. S. 24, 81 L. Ed. 16, 57 S. Ct. 88 (1936).....9, 21

Southern Pacific Company v. *Bogert,* 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919).....12, 32
Standard Gas and Electric Company v. *Taylor,* 113 F. (2d) 266, *cert. den.* —— U. S. —— (October Term, 1940, No. 465), 85 L. Ed. 85.....2, 3, 6, 24

Taylor v. *Standard Gas and Electric Company,* 306 U. S. 307 .....2, 30, 32
Thomas v. *Brownville etc. R. Co.,* 109 U. S. 522, 526, 3 S. Ct. 315, 27 L. Ed. 1018, 1020 (1883).....12, 32

In re Utilities Power & Light Corporation (C. C. A. 7th, March 9, 1940) 23

Statutes Cited

PAGE

Section 240 (a) of the Judicial Code, as amended (28 U. S. C. A. Section 347) 16

Sections 179, 216 (7), 216 (8), and 221 of Chapter X of the Bankruptcy Act, as amended (11 U. S. C. A. Sections 579, 616, 621) 18, 21, 24, 25

Section 276 (c) (2) of Chapter X 18

Other Authorities

34 Ill. Law Review 94 (1939) 30

25 Va. Law Review 849 (1939) 30

39 Col. Law Review 907, 927, 928 (1939) 30

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

To the Honorable, The Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Standard Gas and Electric Company, by its counsel, A. Louis Flynn, Jacob K. Javits, Wilbur J. Holleman and Selig J. Levitan, alleges:

INTRODUCTORY STATEMENT

Petitioner prays that Writs of Certiorari issue to review the judgment and decision of the Circuit Court of Appeals for the Tenth Circuit entered on January 13, 1941 (R. 1687) affirming orders of the District Court for the Northern District of Oklahoma approving (R. 1385) and confirming (R. 1397) a plan of reorganization which denies to Standard Gas and Electric Company (hereinafter referred to as Standard) any participation in the reorganized company upon its amended claim in the amount of $6,129,248.36, or as a common stockholder or for the stock and assets of the Refining Company. Appeals to the Circuit Court from both orders were consolidated (R. 1688).

On November 12, 1940, this Court denied the petition of Standard for certiorari to review a decision of the Circuit Court of Appeals for the Tenth Circuit, reported in 113 F. (2d) 266, (R. 1372) which affirmed, on the ground of the decision of this Court in *Taylor* v. *Standard Gas and Electric Company*, 306 U. S. 307, an order of the District Court for the Northern District of Oklahoma (R. 159) denying to Standard any participation as a creditor and directing Standard to deliver to the Trustee of the Debtor the stock and assets of the Refining Company. U. S. , October Term, 1940, No. 465, 85 L. Ed. 85.

This petition seeks the review of orders approving and confirming the plan of reorganization. The order of confirmation is the final and dispositive order which completely and permanently excludes Standard from participation in the assets of the Debtor. Petitioner in filing this petition is prompted to do so by the doctrine expressed in *Hamilton-*

Brown Shoe Co. v. *Wolf Bros. & Co.*, 240 U. S. 251, 36 S. Ct. 269, 60 L. Ed. 629 (1916), concerning the effect of a refusal of an application for a writ of certiorari to review an interlocutory decision, and concerning this Court's power to correct an erroneous interlocutory decision which it had previously declined to review.[1] In view of that doctrine, Standard's tremendous net cash investment in Deep Rock of $20,567,763.74 (R. 1270) obliges it, in the interests of its 58,000 public security holders (R. 1268), to seek from this Court a last opportunity to correct the decisions of the courts below.

STATEMENT OF THE MATTER INVOLVED

The facts, in so far as they relate to the plan of reorganization confirmed below, the distribution of securities thereunder, the value of the Debtor's assets, and the elimination of Standard's interests as a creditor and common stockholder are set forth in the opinion of the Circuit Court of Appeals (R. 1687). The plan itself appears at page 1466 of the Record.[2] We supplement such statement only

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[1]The Circuit Court of Appeals in the decision reported in 113 F. (2d) 266 (R. 1377-1378), relating to the order of February 29, 1940, which subordinated Standard's claim, stated that the order of approval of the Plan of Reorganization "is not a judgment. It is but a step in the administration of the Debtor's estate. * * * If, before the final *consummation* of any plan of reorganization, the assets of Deep Rock should so increase in value that there would be a substantial equity to be applied to the satisfaction of Standard's claim, the Court under its broad equitable powers would have power to procure a modification of the plan to make this equity available to Standard."

[2]Pursuant to a stipulation of the parties, the Record on this petition includes the Record filed in Case No. 465, October Term, 1940 (R. 1697).

to the extent deemed material to the issues presented by this petition.

On January 29, 1940, the Trustee filed a report (R. 123) to which was attached a summary of a statement received from the holders of notes and preferred stock in response to an order of the District Court (R. 133). Of the holders of 70.13% of notes who responded to the order of the District Court, approximately two-thirds had purchased their securities subsequent to March 1, 1933 (the date of the beginning of the proceedings), some at prices as low as 20% of the principal amount of such notes (R. 133). The precise prices paid by note holders were not disclosed, but attached to the report of the Trustee were statements of the market prices at which notes and preferred stock of the Debtor were traded in since March 1933 (R. 134-137). It will be observed that since March 1933, such notes have been traded in "flat" *i.e.*, the prices have been inclusive of accrued interest. It will also be observed that out of the $4,114,500 principal amount of notes reported to have been acquired after the inception of the proceedings, $3,000,000 principal amount were acquired at less than 75% of face value, "flat" (*i.e.*, inclusive of accrued interest) (R. 133). Accrued interest during the receivership (since March 1, 1933)—not paid for by those who purchased their securities "flat"—amounted to $4,350,000 (or 43.5% of principal) on May 31, 1940 (R. 1690).

The same report shows with respect to the preferred stock that reports were received from the holders of 62.75% of the outstanding stock; that approximately 25% of the reporting stock was purchased or acquired subsequent to

March 1, 1933, some at prices less than $5. per share and all but 512 of such reporting shares at less than $25 a share (R. 134).

The District Judge, in his findings of fact of February 29, 1940, found that "since the inception of the receivership proceedings and the reorganization proceedings of the Debtor", large percentages of notes and preferred stock of the Debtor have been acquired by the present holders "at prices substantially below the principal amount thereof in the case of notes, or the preferential rights in liquidation in the case of the preferred stock" (R. 150). When the District Court admitted the Trustee's report in evidence, he stated that its subject matter was relevant to the measurement of the rights of notes and preferred stockholders "according to equitable principles" (R. 1239).

Notwithstanding the order of December 15, 1939 (R. 72) and the report of the Trustee pursuant thereto, the District Court, in the order of July 24, 1940, confirming the Plan of Reorganization (R. 1397), found that it would be impracticable to require the holders of securities of Deep Rock to file a statement showing the prices paid therefor due to the number of securities outstanding and the extent of public dealing therein. The record contains no evidence which supports this finding in the order of July 24th. The District Court disregarded the facts disclosed by the Trustee's report pursuant to the order of December 15th, and approved the plan as fair and equitable.

Standard respectfully refers this Court to, and prays that this Court read particularly the evidence at pages 1264-1271, 1275-1276, and 1296-1307 of the Record. This evidence was given early in 1940, after the decision by this

Court in the *Taylor* case. It contains facts relating to Standard's amended claim and relations with Deep Rock prior to March 1, 1933, which were not before this Court in the record in the *Taylor* case and which bear directly on the issue of the fairness of a plan of reorganization which excludes Standard from participation. This evidence in specific detail negates the charges in the *Taylor* case of abuse of Deep Rock by Standard.

Granted the subordination of Standard, there is no question in this case about the fact that the Debtor's assets ($17,640,415) exceed the Debtor's liabilities ($14,-350,000). (Opinion the Circuit Court of Appeals (R. 1689).) Standard, as a creditor, and the common stockholders as a class, were given no opportunity to accept or reject the plan, notwithstanding that fact.

The Circuit Court of Appeals affirmed the orders of approval and confirmation (R. 1691) on the ground that under its previous decision (reported at 113 F. (2d) 266[1] (R. 1372 *seq.*)), Standard is not entitled to any participation. The previous decision in effect held that the Circuit Court was bound by this Court's decision in the *Taylor* case to subordinate Standard's claim even to the point of excluding Standard from participation in the reorganization of the Debtor. Thus it is argued that the decision below is the inevitable consequence of this Court's decision in the *Taylor* case. To Standard's contention that the facts showed that it was not impracticable to require the holders of securities to file statements showing the prices paid therefor and that these prices had a bearing on the fairness of the plan, the Circuit Court replied that the

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[1]Cert. den. October Term 1940, No. 465.

filing of the statements would not have benefited Standard, absent fraud on the part of the security holders.

QUESTIONS PRESENTED

1. Since the Debtor has not been found to be insolvent, and since provision has been made for the full satisfaction of the prior rights of creditors, leaving only the participation of stockholders to be determined, may a plan of reorganization under the Bankruptcy Act, as amended, entirely exclude from participation Standard as a subordinated creditor, and the common stockholders (of which Standard is the largest) without their consent?

2. As a cognate question: Does the rule of absolute priorities apply to the adjustment of the rights of preferred stockholders, a subordinated creditor (Standard) and the common stockholders, where the Debtor is solvent and the provision has been made for the full satisfaction of the prior rights of the creditors?

3. Since the plan of reorganization excludes Standard, as a creditor, from participation, was it properly approved as fair and equitable, taking into consideration:

   a. Standard's amended claim for $6,129,248.36, of which $1,000,000 is for moneys paid directly to the holders of notes on account of interest, $597,129.75 represents moneys paid directly to the holders of preferred stock on account of dividends and $1,300,428.98 represents moneys provided to the Debtor for the purpose of enabling it to pay essential operating and corporate expenses (all between February 24, 1928 and February 28, 1933).

b. The transfer by Standard, as directed by the District Court, of the stock and note of the Refining Company, the Bradstreet Properties and the Cracking Plant, representing a net cash investment of Standard of $2,082,026.30 from which Deep Rock and its security holders benefited.

c. That since the beginning of the receivership of Deep Rock in 1933 "speculators" have acquired notes of the Debtor at prices as low as 20% of the principal amount thereof "flat" (*i.e.*, inclusive of accrued interest since March 1, 1933) and preferred stock at prices as low as (and less than) $5 per share, and that the plan of reorganization recognizes a priority in favor of such "speculators" over Standard to the extent of principal of the notes plus interest since March 1, 1933 at the rate of 6% per annum and the par value in liquidation of the preferred stock with dividends thereon at the rate of $7 per share per annum since 1931.

d. The evidence received by the District Court in February, 1940 (R. 1264-1271, 1275-1276, and 1297-1307) after the decision by this Court in the *Taylor* case.

REASONS FOR GRANTING CERTIORARI

A. The Circuit Court of Appeals has decided important questions of law which have not been but which should be settled by this Court.

We state briefly what these questions are; we believe that this statement will show the importance of the questions and the need for their final settlement by this Court.

1. Where a Debtor is solvent and where provision has been made for the satisfaction of the full prior rights of creditors, Sections 179 and 216(7) and (8) of the Bankruptcy Act, contemplate that the rule of relative priorities should apply to the adjustment of the rights of several classes of stockholders.

We respectfully submit that this question was not involved in *Case* v. *Los Angeles Lumber Products Co. Ltd.*, 308 U. S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (1939), where, as in *In re 620 Church Street Bldg. Corp.*, 299 U. S. 24, 81 L. Ed. 16, 57 S. Ct. 88 (1936), the Debtor was insolvent. Nor was the question involved in *In re Consolidated Rock Products Co.*, U. S. (October Term, 1940, Nos. 400 and 444), where, quoting from *Louisville Trust Co.* v. *Louisville, New Albany and Chicago Railway Co.*, 174 U. S. 674, 684, this Court held that " 'any arrangement of the parties by which the subordinated rights and interests of the stockholders are attempted to be secured at the expense of the prior rights' of creditors 'comes within judicial denunciation' ". Here, the prior rights of creditors have been fully satisfied; the question is whether the rule of absolute priorities applies to the adjustment of the rights of the preferred stockholders, the subordinated creditor (Standard) and the common stockholders. This question has not yet been passed on by this Court.

2. Does equity require the reorganization court, in this case, to take into consideration in the determination of whether the plan is fair and equitable to Standard the actual prices paid by holders of notes and preferred stock who acquired such securities during the pendency of the reorganization proceedings at discounts below their face

value? The plan of reorganization which was confirmed excludes Standard's fifty-eight thousand security holders, who (through Standard) have an investment of upwards of $20,000,000 in cash in the Debtor, from any participation in the assets of a solvent Debtor in favor of holders of notes and preferred stock who have acquired their securities during the receivership and reorganization proceedings at prices but a small fraction of the principal amount of such securities and who will inevitably gain a wind-fall no matter what provision may be made for Standard's protection. If priority over Standard is limited to the prices paid for securities (as low as 20¢ on the dollar for notes, inclusive of six or seven years of accrued interest, and as low as $1 a share for the preferred stock, inclusive of seven or eight years of accrued dividends of $7 per share per annum), would the note holders and preferred stockholders be treated unfairly if Standard were then to be permitted to participate?

B. A second reason why certiorari should be granted is that the Circuit Court of Appeals has rendered a decision in conflict with the decision of another Circuit Court of Appeals on the same question.

In *Campbell* v. *Alleghany Corporation,* 75 F. (2d) 947 (1935), cert. den. 296 U. S. 581, the Circuit Court of Appeals for the Fourth Circuit took the view that, in the case of a solvent company, "Any plan must be accepted by the holders of a majority of the stock affected as well as approved by the court, or, if the consent of a majority be not obtained, their equity must be fully protected by the court in one of the methods prescribed in the act." This view is in conflict with the decision below.

C. A third reason why the writs of certiorari should be granted is that it is necessary in order to permit the correction of a grave injustice.

A grave injustice and inequity has been done to the public security holders of Standard (R. 1268) whose interests have been entirely excluded from participating in the reorganization of Deep Rock.

Since 1928, $1,000,000 of Standard's money went directly to the note holders of the Debtor and $597,129.75 of Standard's money went directly to the preferred stockholders of the Debtor (R. 1269); nevertheless, Standard is excluded from participation for the benefit of the very persons who received these moneys. Standard is excluded because holders of notes, many of whom have purchased at a substantial discount below the face amount thereof, with full knowledge of Standard's contention that it has the right to participate and of Standard's equities, by the orders which petitioner seeks to have reviewed, are held entitled to collect interest at the rate of 6% per annum since 1933—not on the amount they paid for their notes but on the principal amount thereof.

The courts below have obviously made an erroneous assumption that since, under the *Taylor* case, Standard's right to participate in the reorganization must be subordinated, they are precluded from taking into consideration on the subject of fairness of the plan the subsequent evidence bearing directly on the issue of fairness. After the decision in the *Taylor* case, evidence was received by the District Court directly negating the inferences which appear to be the rationale of the decision by this Court in the *Taylor* case (R. 1296-1307). We submit that a court of equity in passing upon the fairness of a plan of reorganization was bound to take into consideration that evidence.

The plan of reorganization is unfair in its exclusion of Standard under the doctrine expressed by this Court in *Southern Pacific Company* v. *Bogert,* 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919), and in *Thomas* v. *Brownville etc. R. Co.,* 109 U. S. 522, 526, 3 S. Ct. 315, 27 L. Ed. 1018, 1020 (1883). The District Judge recognized the unfairness to Standard, stating:

> "I agree with you it is inequitable to subordinate your claim to the full amount of these note holders, taking into consideration the actual consideration paid by speculators for their notes pending this bankruptcy proceeding, but the Supreme Court of the United States in this case, without going into details, said your claim must be subordinated to the note holders and to the preferred stockholders" (R. 1314).

While recognizing the unfairness of the plan (R. 1309, 1314), the District Judge considered himself precluded from giving effect to his views when the issue of fairness of the plan came before him. This erroneous view, petitioner submits, resulted in the confirmation of an unfair plan. Fairness demands that Standard should not be cut off permanently from participation in the assets of Deep Rock, which, the Circuit Court found, are susceptible of rapid increase in value (R. 1377).

PRAYER

WHEREFORE, petitioner respectfully prays that Writs of Certiorari be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Tenth Circuit commanding that Court to certify and send to this Court, on a day certain to be

therein designated, a full and complete transcript of the record and of all proceedings in this cause, to the end that this case may be reviewed and determined by this Court; and that the said decrees of the said Circuit Court of Appeals in the said cases, and every part thereof, may be reversed by this Court; and that petitioner may be granted such other and further relief as may be appropriate.

Dated: New York, March 14, 1941.

A. Louis Flynn,
Jacob K. Javits,
Wilbur J. Holleman
Selig J. Levitan,
Attorneys for Petitioner.

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BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI

OPINION OF THE COURT BELOW

The opinion in the Circuit Court of Appeals is not yet reported in the official reports. A copy of the opinion appears in the record at pages 1686, *seq.*

JURISDICTION

The decrees of the Circuit Court of Appeals were entered on January 13, 1941 (R. 1695). The statutory provision which is believed to sustain the jurisdiction of this Court is Section 240 (a) of the Judicial Code, as amended (28 U. S. C. A. Section 347).

QUESTIONS PRESENTED

1. Since the Debtor has not been found to be insolvent, and since provision has been made for the full satisfaction of the prior rights of creditors, leaving only the participation of stockholders to be considered, may a plan of reorganization under the Bankruptcy Act, as amended, entirely exclude from participation a subordinated creditor and the common stockholders without their consent?

2. As a cognate question: Does the rule of absolute priorities apply to the adjustment of the rights of preferred stockholders, a subordinated creditor (Standard) and the common stockholders, where the Debtor is solvent and the provision has been made for the full satisfaction of the prior rights of the creditors?

3. Since the plan of reorganization excludes Standard, as a creditor, from participation, was it properly approved as fair and equitable, taking into consideration:

   a. Standard's amended claim for $6,129,248.36 of which $1,000,000 is for moneys paid directly to the holders of notes on account of interest,

$597,129.75 represents moneys paid directly to the holders of preferred stock on account of dividends and $1,300,428.98 represents moneys provided to the Debtor for the purpose of enabling it to pay essential operating and corporate expenses (all between February 24, 1928 and February 28, 1933).

b. The transfer by Standard, as directed by the District Court, of the stock and note of the Refining Company, the Bradstreet Properties and the Cracking Plant, representing a net cash investment of Standard of $2,082,026.30 from which Deep Rock and its security holders benefitted.

c. That since the beginning of the receivership of Deep Rock in 1933 "speculators" have acquired notes of the Debtor at prices as low as 20% of the principal amount thereof "flat" (*i.e.,* inclusive of accrued interest since March 1, 1933) and preferred stock at prices as low as (and less than) $5 per share, and that the plan of reorganization recognizes a priority in favor of such "speculators" over Standard to the extent of principal of the notes plus interest since March 1, 1933 at the rate of 6% per annum and the par value in liquidation of the preferred stock with dividends thereon at the rate of $7 per share per annum since 1931.

d. The evidence received by the District Court in February 1940 (R. 1264-1271, 1275-1276, and 1297-1307) after the decision by this Court in the *Taylor* case.

THE STATUTES INVOLVED

The statutes involved are Sections 179, 216 (7), 216 (8), and 221 of Chapter X of the Bankruptcy Act, as amended (11 U. S. C. A. Sections 579, 616 and 621).[1]

The pertinent portion of Section 179 provides as follows:

> "Sec. 179. After a plan has been accepted in writing, filed in court, by or on behalf of creditors holding two-thirds in amount of the claims filed and allowed of each class, and, if the debtor has not been found to be insolvent, by or on behalf of stockholders holding the majority of stock, of which proofs have been filed and allowed, of each class, exclusive of creditors or stockholders or of any class of them who are not affected by the plan or whose claims or stock are disqualified pursuant to section 203 of this Act, or for whom payment or protection has been provided as prescribed in paragraph (7) and (8) of section 216 of this Act, the judge shall fix a hearing, * * *"

The pertinent portions of the other sections of the Bankruptcy Act are contained in Exhibit A attached to this brief.

STATEMENT OF THE CASE

The essential facts of the instant case have been stated in the foregoing petition to which reference is respectfully made.

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[1]The District Court, acting under Section 276(c)(2) of Chapter X, found it practicable to apply these sections to this proceeding (R. 1576).

SPECIFICATIONS OF ERROR

1. The Circuit Court of Appeals erred in finding that the Second Amended Plan of Reorganization is fair and equitable, in the face of the facts that the Debtor is solvent, that provision has been made for the full satisfaction of the prior rights of creditors, leaving only the participation of stockholders to be considered, and that Standard was denied participation as a creditor and as a common stockholder.

2. The Circuit Court of Appeals erred in holding that the rule of absolute priorities applies in the adjustment of the rights of the several classes of stockholders, notwithstanding the fact that provision has been made for the full satisfaction of the prior rights of creditors and that the Debtor is solvent.

3. The Circuit Court of Appeals erred in holding that the reorganization court is not required, in determining whether a plan is fair and equitable, to take into consideration the actual prices paid for notes and preferred stock by persons who acquired such securities during the pendency of the reorganization proceedings at great discounts from their face value, notwithstanding the particular facts of this case.

4. The Circuit Court of Appeals erred in holding that it was not practicable to require the holders of securities to file statements showing the prices paid therefor, in the face of the fact that such statements had in fact been filed by the holders of more than 70% of the outstanding notes and by the holders of 62.75% of the outstanding preferred stock.

5. The Circuit Court of Appeals erred in not taking into consideration, on the issue of the fairness of a plan excluding Standard from participation, the testimony received by the District Court early in 1940 (after the decision of the *Taylor* case) relating to Standard's amended claim and relating to Standard's dealings with the Debtor prior to March 1, 1933.

6. The Circuit Court of Appeals erred in holding that as a matter of law the Second Amended Plan of Reorganization was accepted by or on behalf of two-thirds in amount of creditors and stockholders holding a majority of the stock affected by the Plan, notwithstanding the fact that Standard as a creditor in a separate class and the holders of a majority of the common stock of the Debtor did not accept the Plan and notwithstanding the fact that the Debtor is solvent.

SUMMARY OF ARGUMENT

For the sake of brevity, reference is respectfully made to the "Reasons for Granting Certiorari" contained in the foregoing petition.

ARGUMENT

POINT I

WHERE A DEBTOR IS NOT INSOLVENT, AND HERE PROVISION HAS BEEN MADE FOR THE FULL ATISFACTION OF THE PRIOR RIGHTS OF CREDI-ORS, LEAVING ONLY THE PARTICIPATION OF TOCKHOLDERS TO BE CONSIDERED, A PLAN OF EORGANIZATION MAY NOT BE CONFIRMED WITH-UT THE CONSENT OF EXCLUDED CREDITORS AND TOCKHOLDERS, UNLESS PAYMENT OR PROTECTION PROVIDED FOR SUCH EXCLUDED CREDITORS AND TOCKHOLDERS IN A MANNER PRESCRIBED IN SEC-ON 216(7) AND (8) OF THE BANKRUPTCY ACT, AS MENDED.[1]

We respectfully submit that this question was not in-lved in *Case* v. *Los Angeles Lumber Products Co. Ltd.*, 8 U. S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (1939), where, as *In re 620 Church Street Bldg. Corp.*, 299 U. S. 24, 81 Ed. 16, 57 S. Ct. 88 (1936), the Debtor was insolvent. those cases there was a finding of insolvency and the ue involved was the right of a stockholder or junior editor to participate in the assets of the Debtor before the ior creditor had received satisfaction in full. A similar uation prevailed in *In re Consolidated Rock Products* ., U. S. (October Term, 1940, Nos. 400 and

[1]Granted the subordination of Standard, there is no question this case about the fact that the Debtor's assets ($17,640,415) ceed the Debtor's liabilities ($14,350,000). (Opinion of the rcuit Court of Appeals (R. 1689.) There are ample assets ilable to discharge fully the prior rights of creditors.

444), where this Court stated that the rule of absolute priorities applies to solvent as well as insolvent companies. We understand that statement, in the light of the facts of that case, to hold that stockholders may not participate until the full prior rights of creditors have been satisfied. In this case, however, the prior rights of creditors have been fully satisfied and what remains to be done is to adjust the rights of stockholders (and Standard, the subordinated creditor) among themselves. Whether the rule of absolute priorities applies to the circumstances has not been decided by this Court. We urge that on principle, as a matter of law, and in equity because of the particular facts of this case, a different rule should here prevail.

It is of the essence of the contract between the creditor and the corporation and between the stockholder and the corporation that the creditors must be paid in full before the stockholder may share in the assets. Similar is the relationship between the senior creditor and the junior creditor. That contract is the basis of the doctrine of the *Consolidated Rock Products* case and its predecessors. Far different, however, is the contract between the preferred stockholder and the common stockholder. In this case, that contract is expressed on the certificate of preferred stock which is a part of the record (R. 1346 B). It entitles the preferred stock to a priority in the division of earnings and to a priority in the distribution of assets only in liquidation. It does not provide for the exclusion of the common stockholder when at any given moment the value of the assets is such that upon a liquidation at that moment, satisfaction of the rights of the preferred stock would leave no remaining value for the common stockholder.

The preferred stockholders of this corporation have no rights of foreclosure under the corporate charter, nor the right under the corporate charter to demand a liquidation at any time; nor have they the right to call for a termination of the corporate venture. We submit that the terms of the charter are a contract between the preferred stockholders and the common stockholders and that where there is any equity for stockholders of any class, no class of stockholder may be frozen out of a reorganization by the logical fallacy of assuming that that class is "not affected" and, therefore, need not be consulted.

> *Louisville Jt. Stock L. B.* v. *Radford,* 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593 (1935).

To exclude the junior interests without their consent (in the case of a solvent debtor where provision has been made for the satisfaction in full of the rights of prior creditors) would be to confer upon the preferred stockholders rights which were never conferred upon them by the charter or contract and to take away from Standard its contractual rights. We submit that Congress has no power to require such a result in the case of a solvent Debtor, and that Congress, in enacting the Bankruptcy Act, expressly sought to avoid any unconstitutional exercise of its bankruptcy power by expressly requiring consents in the case of solvent corporations.[1]

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[1]In *In re Utilities Power and Light Corporation* (C. C. A. 7th, March 9, 1940) the Circuit Court of Appeals for the Seventh Circuit dismissed on motion an appeal from an order of confirmation. One of the points raised by the appellant, a commit-

Jurisdiction over "bankruptcies" does not include jurisdiction to alter the contract of stockholders of a solvent company without their consent.

The argument may be advanced that the result would be the same even if the procedures of Section 216 (7) and (8) were observed. But this is speculation and may well not be so. No short cut method ought to be substituted by a District Court for the statutory procedure provided by Congress; such judicial legislation would evade the Congressional intent, would destroy the standards of orderly judicial procedure, as prescribed by the legislature, and would substitute an erratic and unpredictable system for the orderly and uniform system of Bankruptcy Laws enacted by Congress. It is impossible here to separate substance from form, and evasion of the forms has resulted in a destruction of substantive values.

Neither Standard as a creditor, nor the common stockholders as a class, accepted (nor was there afforded them an opportunity to accept) the plan of reorganization, presumably on the theory that they were "not affected by the plan".

Granting that under the decision of this Court in the *Taylor* case and of the Circuit Court of Appeals in the

---

tee of junior interests which had been excluded from the reorganization, is the point discussed in the text of this brief. The motion to dismiss the appeal was based on five grounds, four of which would have no relevance at all to this case. Since the Circuit Court did not indicate the reason for dismissal, that decision casts no light on the question discussed in the text. And *cf. Campbell* v. *Alleghany Corporation*, 75 F. (2d) 947 (C. C. A. 4th, 1935), cert. den. 296 U. S. 581.

decision reported in 113 F. (2d) 266 (R. 1372), Standard as a creditor is in a separate and deferred class, there is, therefore, a class of creditors which is affected by and has not accepted the plan. Standard is "affected" because, under the decision of the Circuit Court of Appeals reported in 113 F. (2d) 266, until consummation, an increase in the value of the Debtor's assets would entitle Standard to participate. The order confirming the Plan certainly "affects" Standard adversely, realistically and actually, because henceforth Standard will not be entitled to participate, come what may. Further, Standard as a common stockholder is "affected" in the same sense. The creditor and the common stockholder are now to be forever barred. It is the confirmation of the plan that bars them.

To say that Standard is not affected because it has no equity is, we submit, to beg the question. The act sets forth four methods of making adequate provision for a creditor, and three for a stockholder, none of which is here employed. We submit that these methods are exclusive methods to be employed, and that only through the employment of these methods can the requirements of the act and of due process be discharged.

The reorganization sections of the Bankruptcy Act by their terms constitute an equitable method of reorganizing interests in estates of debtors in financial difficulty. They are designed to avoid foreclosure of junior interests, particularly in the absence of a finding of insolvency. In setting up methods for the reorganization of Debtors, these objectives were undoubtedly in the legislative contemplation. Absent the consent expressly required by Section 179, subdivisions (7)(d) and (8)(c) of Section 216 provide for the use of such other method as will equitably

and fairly provide such protection. Even if Standard, as a creditor, be deferred to the notes and preferred stockholders, the plan must make equitable and fair provision for Standard's protection.

Sound legal and economic principles require that the rule of relative priorities be applied to the adjustment of the rights of several classes of stockholders of a corporation, where provision has been made for the full satisfaction of the prior rights of creditors. We agree that the rule expressed in *In re Consolidated Rock Products Company* and in *Case* v. *Los Angeles Lumber Products Co. Ltd.* is a sound rule, founded upon sound legal and economic principles; it is of the essence of the contractual and economic relationship between the stockholders and the creditors that the capital contributed by the former should be a cushion for the satisfaction of the claims of the latter.

We maintain, however, that in the adjustment of the relationships between classes of stockholders of a solvent company, where creditors have been fully provided for, there are powerful economic and social, as well as legal arguments in support of the application of the rule of relative priorities. On the basis of the contract of the parties (R. 1346 B), as we have pointed out, the preferred stock is not entitled to a priority over the common stock except in the distribution of earnings and except in the event of a distribution in liquidation. Absent express permissive provisions in the contract, the preferred stockholder is not entitled to foreclose junior classes of stock at any given time when the liquidation value of the assets of a company, while ample to satisfy the prior claims of creditors, is insufficient to satisfy the preferential rights in liquidation of the preferred stockholder. All stock capital must be

considered risk capital; in exchange for preferential rights stated in the contract, the preferred stockholder has expressly consented to a continuance of the enterprise until the common stockholders or creditors bring about a liquidation. The refusal of courts to compel a Board of Directors representing common stock interests to declare dividends on preferred stock, in the absence of circumstances akin to fraud or breach of trust, is but one example of the recognition by the courts of the fact that the relationships between the preferred stockholder and the common stockholder of a solvent company are governed by their contract.

If as a result of the application of a rule of absolute priorities to the relationships between the preferred and common stockholders of a solvent company, the common stock may be eliminated, investments in junior stock will inevitably be further discouraged. It has recently been pointed out, in the public press and in the reports of Congressional investigators, that the welfare of the country requires the encouragement of investments in equity securities of corporations rather than in debt securities. Public policy is against the application of a rule of foreclosure against junior interests in the circumstances of this case.

We submit, therefore, that sound principle, based on contractual agreement and public policy, requires the application of the rule of relative priorities in the adjustment of the relations of the equity interests in a solvent corporation.

POINT II

EQUITY REQUIRES THE REORGANIZATION COURT TO TAKE INTO CONSIDERATION IN THE DETERMINATION OF WHETHER THE PLAN IS FAIR AND EQUITABLE TO STANDARD (UNDER THE PARTICULAR CIRCUMSTANCES OF THIS CASE (1) THE ACTUAL PRICES PAID BY HOLDERS OF NOTES AND PREFERRED STOCK WHO ACQUIRED SUCH SECURITIES DURING THE PENDENCY OF THE REORGANIZATION PROCEEDINGS AT DISCOUNTS BELOW THEIR FACE VALUE, AND (2) THE EVIDENCE RECEIVED BY THE DISTRICT COURT SUBSEQUENT TO THE DECISION BY THIS COURT IN THE *TAYLOR* CASE.

The plan of reorganization which was confirmed excludes Standard (the receptacle of the investments of fifty-eight thousand security holders), with an investment of upwards of $20,000,000 in cash in the Debtor, from any participation in the highly speculative assets of a solvent Debtor in favor of holders of notes and preferred stock many of whom have acquired their securities during the receivership and reorganization proceedings at prices but a small fraction of the principal amount of such securities and who will inevitably gain a wind-fall no matter what provision may be made for Standard's protection. If priority over Standard is limited to the prices paid for securities after the inception of the reorganization proceedings (as low as 20¢ on the dollar for notes, inclusive of six or seven years of accrued interest, and as low as $1 a share for the preferred stock, inclusive of seven or eight years of accrued dividends of $7 per share per annum), and if relative priorities were preserved with respect to remain-

ing assets, the note holders and preferred stockholders could not reasonably claim to be unfairly treated if Standard is permitted to participate.

The experience of the District Court in obtaining data in response to the order of December 15, 1939 (R. 72, 133-137) shows conclusively that it was practicable in this case to require security holders to file the data required by Section 77B (e)(1).

The relevance of such data, in this case, is this: Because of the decision of this Court in the *Taylor* case, Standard has been moved down from its normal position as a creditor. The question is whether subordination should be converted into the penalty of exclusion. We say that fairness would preclude such a result and that it is relevant to the issue of fairness to see how much was paid for such of the securities by holders who claim the benefit of the exclusion as were acquired after the inception of the proceedings. Standard has not participated in the control of Deep Rock since the beginning of the proceedings; those who purchased securities since then have done so with full knowledge of Standard's claim and those who purchased prior to the decision by this Court in the *Taylor* case must have assumed that Standard was entitled to participate ratably with the notes and in priority to the preferred stock. We are not suggesting a limitation of the claims of the holders of such securities against the Debtor; we do say that the cost of such claims bears directly on the extent to which in fairness Standard should be subordinated to them.

It is a fair and reasonable inference that some, if not the greater number, of the holders of the 29.87% of outstanding notes and of the holders of the 37.25% of outstanding preferred stock who failed to report their pur-

chases of notes and preferred stock since March 1, 1933 (as directed by the District Court) purchased at or near the bottom of the prices reported during such period, *i.e.*, notes at 20% to 25% of the principal amount thereof "flat", and preferred stock at about $5 a share. (Compare Trustee's statement of the market prices for Deep Rock's notes and preferred stock during the receivership period, beginning March 1, 1933 (R. 134-137)).

We respectfully submit that equity requires that Standard receive a participation in the reorganized company and that this Court contemplated a participation in its decision in *Taylor* v. *Standard*. This Court stated in that case:

> "If a reorganization is effected the amount at which Standard's claim is allowed is not important if it is to be represented by stock in the new company, provided the stock to be awarded it is subordinated to that awarded to preferred stockholders. No plan ought to be approved which does not accord the preferred stockholders a right of participation in the equity in the Company's assets prior to that of Standard, and at least equal voice with Standard in the management. Anything less would be to remand them to precisely the status which has inflicted serious detriment on them in the past."

Law Review writers are generally in accord with our understanding of the *Taylor* decision.

34 Ill. Law Review 94 (1939);

25 Va. Law Review 849 (1939);

39 Col. Law Review 907, 927, 928 (1939).

We urge especially that the District Court and the Circuit Court of Appeals should have taken into consideration, in determining whether the plan excluding Standard from participation is fair and equitable, the evidence received by the District Court early in 1940 (after the decision in the *Taylor* case) which bears directly on the relationships between Standard and the Debtor prior to March 1, 1933 and on the benefits enjoyed by the public security holders of Deep Rock through cash payments made by Standard to them and to the Debtor. The decision of this Court in the *Taylor* case did not pass on the fairness of a plan of reorganization, at the time of the decision as yet unborn. The doctrine of *res adjudicata* is, therefore, not applicable to this case and the District Court and the Circuit Court of Appeals were not precluded from considering, on the issue of fairness of the plan, facts subsequently incorporated in the record, which, had they been before this Court in the *Taylor* case, would perhaps have brought about a different result in that case. (We refer here particularly to the testimony at pp. 1296-1307 and at pp. 1264-1271 and 1275-1276 of the Record.) Fairness of plan represents a new issue which was presented to the courts below and, petitioners submit, the courts below were obliged to consider the subsequent testimony. The District Court, in the light of this evidence (admitted over objection), did indeed state:

> "I agree with you it is inequitable to subordinate your claim to the full amount of these note holders, taking into consideration the actual consideration paid by speculators for their notes pending this bankruptcy proceeding",

but erroneously considered himself precluded by the decision of this Court in the *Taylor* case from giving any effect to the subsequent evidence, even on the subject of fairness of the plan (R. 1314, *seq.*). The Circuit Court apparently fell into similar error (R. 1690-1691).

We submit also that under the equitable doctrine expressed in *Southern Pacific Company* v. *Bogert* and *Thomas* v. *Brownville etc. R. Co., supra,* the second amended plan of reorganization is unfair and should not have been confirmed. We certainly do not subscribe to the belief of the District Court Judge that he was compelled by the decision of this Court in the *Taylor* case to confirm a plan he considered inequitable (R. 1309, 1314).

Finally, we wish to point out the tremendous margin of error in evaluating oil properties; the Circuit Court recognized the violent fluctuations in the value of oil properties such as this and the prospect of substantial increase in the value of Deep Rock's assets (R. 1377).

Bearing on the question of the fairness of forever excluding Standard, is the fact that the earnings of the Debtor during reorganization have been substantial; and the properties of the Debtor have been improved substantially during the receivership period, according to the undisputed testimony of Mr. Greis, the Trustee. For the five years 1935-1939, total adjusted earnings from operations amount to $10,064,292.20, making the average annual adjusted earnings from operations $2,013,858.44 (R. 1350 B). These earnings are subject to depletion and depreciation charges, estimated by the Trustee to average $1,230,136.13 annually, and to other charges, including interest on prereceivership debt and income taxes (R. 1350 B). The net earnings before interest and federal in-

come taxes, after all depletion and depreciation and all other charges, averaged $538,747.22 during each of the five years in question, reaching a high figure in 1936 of more than $1,000,000 (R. 1350 B). In view of the hypothetical assumption of a $1 price for oil in the future (R. 1210), (compared with a current price of $1.02) and in view of present world conditions, the speculative possibilities of a great increase in Deep Rock's earnings bear directly on the equity of forever excluding Standard and enriching "speculators" in Deep Rock's securities.

As long as Deep Rock's vast speculative resources remain unexploited, Standard should have a right of participation; the cut off date of Standard's interest as a creditor should not be the date of confirmation of a plan of reorganization under the circumstances of this case.

CONCLUSION

We submit that the decisions of the Circuit Court of Appeals and of the District Court are erroneous as a matter of law.

The adjudication of the Circuit Court of Appeals, based on a decision of this Court (in the *Taylor* case) resting on the principles of equity, brings about a result which the District Judge considered inequitable; it would be a sad travesty on the judicial process if injustice and inequity be done in the name of this Court's opinion, rendered in order to do equity. Furthermore, the questions raised by the petition include some of great public importance. They ought to be set at rest by this Court.

It is respectfully submitted that the petition to review the judgment of the Circuit Court of Appeals for the Tenth Circuit should be granted.

Dated: March 14, 1941.

Respectfully submitted,

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EXHIBIT A

Section 216 (7) and (8) and Section 221 (1) and (2) f Chapter X of the Bankruptcy Act:

"Sec. 216—A plan of reorganization under this chapter—

"(7) Shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either, as provided in the plan or in the order confirming the plan,

"(a) By the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or

"(b) By a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or

"(c) By appraisal and payment in cash of the value of such claims; or

"(d) By such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

"(8) Shall provide for any class of stockholders which is affected by the plan and does not accept the plan by the majority of the stock required under this chapter, adequate protection for the realization by them of the value of their equity, if any, in the property of the debtor dealt with by the plan, either, as provided in the plan or in the order confirming the plan,

"(a) By the sale of such property at not less than a fair upset price; or

"(b) By appraisal and payment in cash of the value of their stock; or

"(c) By such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection; Provided, however, That such protection shall not be required if the judge shall determine that the debtor is insolvent;"

"Sec. 221.—The judge shall confirm a plan if satisfied that—

"(1) The provisions of article VII, section 199, and article X of this chapter have been complied with;

"(2) The plan is fair and equitable, and feasible;"

Supreme Court of the United States

October Term, 1945

In the Matter
of
DEEP ROCK OIL CORPORATION, a corporation,
Debtor.

No. 846.

STANDARD GAS AND ELECTRIC COMPANY, a corporation,
Petitioner,
v.
DEEP ROCK OIL CORPORATION, Debtor, ERNEST O. THOMAS, Trustee, JOHN J. SHEPHERD, NEWTON P. FEVE, ROBERT P. [illegible], H. MASON, ALBERT J. ROBERTSON, and CHARLES [illegible], as a Reorganization Committee, JOHN M. TAYLOR, OSCAR [illegible], and H. RUSSELL HASTINGS, as Independent Protective Committee.

No. 847.

STANDARD GAS AND ELECTRIC COMPANY, a corporation,
Petitioner,
v.
DEEP ROCK OIL CORPORATION, Debtor, ERNEST O. THOMAS, Trustee, JOHN J. SHEPHERD, NEWTON P. FEVE, ROBERT P. [illegible], H. MASON, ALBERT J. ROBERTSON, and CHARLES [illegible], as a Reorganization Committee, JOHN M. TAYLOR, OSCAR [illegible], and H. RUSSELL HASTINGS, as Independent Protective [illegible] Committee.

BRIEF ON BEHALF OF THE INDEPENDENT COMMITTEE FOR THE PROTECTION OF THE HOLDERS OF PREFERRED STOCK, THE REORGANIZATION COMMITTEE, AND H. H. GREER, TRUSTEE, IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI

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INDEX

PAGE

I. STATEMENT 1

II. ARGUMENT 5

CONCLUSION 11

CITATIONS

Cases:

Taylor v. Standard Gas and Electric Company, 306 U. S. 307 (1939) 2

Case v. Los Angeles Lumber Products Company, Ltd., 308 U. S. 106 (1939) 7, 9

Northern Pacific Railway Company v. Boyd, 228 U. S. 482 (1913) 7

Consolidated Rock Products Co. v. du Bois, ... U. S. ..... (October Term, 1940, Nos. 400 and 444) 7

Pepper v. Litton, 60 S. Ct. 238, 246; 308 U. S. 295 (1939) 7

In re 620 Church Street Building Corporation, 299 U. S. 24 (1936) 8, 9

In re Utilities Power & Light Corporation, 29 F. Supp. 763, 769 (D. C. N. D. Ill., 1939), app. dis. 7 Cir. C. C. A. on March 9, 1940, without opinion, Causes Nos. 7221, 7222 10

In re National Food Products Corporation, 23 F. Supp. 979 (D. C. Md., 1938) 10

Continental Insurance Co. v. Louisiana Oil Refining Corporation, 89 F. (2d) 333, 338 (C. C. A. 5th, 1937) 10

PAGE

In re Chicago, Great Western Railroad Company, 29 F. Supp. 149 (D. C. N. D. Ill., 1939) 10

Campbell v. Alleghany Corporation, 75 F. (2d) 947 (C. C. A. 4th, 1935), cert. den. 296 U. S. 581 11

Miscellaneous:

Finletter's Bankruptcy Reorganization (1939), p. 417 10

Moore's Bankruptcy Manual (1939), p. 575 11

Gerdes, Corporate Reorganizations, Vol. 2, p. 1726 (1936) 11

53 Harvard Law Review 713 (March, 1940) 11

34 Illinois Law Review 589 (January, 1940) 11

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BRIEF ON BEHALF OF THE INDEPENDENT COMMITTEE FOR THE PROTECTION OF THE HOLDERS OF PREFERRED STOCK, THE REORGANIZATION COMMITTEE, AND H. N. GREIS, TRUSTEE, IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI.

I.

STATEMENT

Under date of November 12, 1940, this Court denied the petition for writ of certiorari dated September 26, 1940, filed by Standard Gas and Electric Company (hereinafter

referred to as "Standard") to review the unanimous judgment entered by the Circuit Court of Appeals for the Tenth Circuit on June 29, 1940 (113 F. (2d) 266) affirming the order of the District Court of the United States for the Northern District of Oklahoma entered February 29, 1940.

The decree of the District Court entered February 29, 1940, ordered:

> "(1) That the claims of the creditors and noteholders and the interests of the preferred stockholders in the amounts found due by this court, are to be satisfied in full before Standard is entitled to participate in the assets of the Debtor in liquidation, reorganization or any other manner whatsoever.
>
> "(2) That the common stock of the Debtor, and whatever claims Standard Gas and Electric Company may have as a creditor against the Debtor, are without value, since the claims of the creditors and noteholders and the interests of the preferred stockholders substantially exceed the value of the assets of the Debtor.
>
> "(3) Standard Gas and Electric Company is not entitled to participate in the reorganization of the Debtor." (R. p. 160)

The foregoing decree of the District Court was the necessary consequence of the opinion and mandate of this Court in *Taylor* v. *Standard Gas and Electric Company,* 306 U. S. 307 (1939).[1]

In conformity with the order of the District Court entered February 29, 1940, the Reorganization Committee presented a Plan of Reorganization eliminating Standard from participation as a creditor and common stockholder. This Plan, entitled the Second Amended Plan of Reorganization, as modified May 20, 1940, was approved on May 28,

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[1]See our brief filed in opposition to Standard's petition for certiorari, Supreme Court of the United States, October term 1940, No. 465.

1940 by the District Court under Section 174 of Chapter X of the Bankruptcy Act, as amended, and was finally confirmed by the District Court on July 24, 1940, under Section 179 of said Chapter. Standard's appeals from the orders approving and confirming the Plan were consolidated by the Circuit Court of Appeals, which unanimously affirmed such orders on January 13, 1941. (R. pp. 1687-1696)

As stated by the Circuit Court of Appeals:

> "In its order of February 29, 1940, and again in its order of July 24, 1940, the trial court expressly found that the assets of the debtor were not sufficient in value to satisfy in full the claims of the noteholders and the preferred stockholders. It follows under our holding In re Deep Rock Oil Corporation, 113 F. (2d) 266, Standard is not entitled to participate." (R. p. 1691)

By the instant petition Standard seeks to review the orders of the District Court approving and confirming the Plan entered without objection by any other party, which orders merely implemented and gave effect to the decree of February 29, 1940, in so far as the elimination of Standard is concerned. The pending petition is confessedly an effort to relitigate in this Court the status and right of Standard to participate in the reorganization of the Debtor. (Pet. pp. 2-3)

There has been no substantial change in the value of the assets of the Debtor. As has been the case since the District Court first appraised the Debtor's assets in 1936 (306 U. S. 307, 314), the interests of the holders of Deep Rock notes and preferred stock greatly exceed in the aggregate the value of such assets. In the order of confirmation entered July 24, 1940 (being the second of the two orders here sought to be reviewed), the District Court found that the value of the Debtor's assets

> "is not now in excess of $15,600,000 after the second interim distribution ordered to be paid on May 9,

> 1940;[2] that said assets are not now of sufficient value to satisfy in full the claims and interests respectively, of the holders of the presently outstanding Convertible Gold Notes and Preferred Stock of the Debtor; that all of the claims of Standard, including the claim with reference to the assets of Deep Rock Oil and Refining Company, and the interests of the holders of Common Stock are without value; and that Standard, as a claimant and the said holders of Common Stock, including Standard, are not affected by the Plan." (Rec. p. 1408)

Standard does not challenge the finding of value thus made as of July 24, 1940 in the confirmation order, which order Standard admits to be "final and dispositive." (Pet. p. 2) It is thus conceded that the possible enhancement in value of the assets of Deep Rock and the creation thereby of an equity for Standard, to which the Circuit Court of Appeals referred in the decision reported in 113 F. (2d) 266 (R. pp. 1377-1378) has not been realized.

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[2]The two interim distributions aggregated $2,400.000.

II.

ARGUMENT

In stating its "reasons for granting certiorari" (Pet. pp. 8-12) Standard reasserts in various forms arguments presented in its petition for certiorari denied by this Court on November 12, 1940, as follows:

> (a) That its claim against Deep Rock, which has been subordinated by this Court in the *Taylor* case, is meritorious, as shown by the record, including the evidence presented to the District Court in January of 1940 prior to the entry of the order of February 29, 1940.
>
> (b) That it is unfair to exclude Standard from participation in the light of the prices paid by the public holders of notes and preferred stock.
>
> (c) That in view of the so-called "speculative resources" of Deep Rock and its "fluctuating" record of earnings, Standard should not be eliminated from participation as required by the February order and as made effective by the orders here sought to be reviewed.

In the briefs filed last October in Cause No. 465, the undersigned and the Securities and Exchange Commission fully met the above arguments, as follows:

> (a) All items of the claim of Standard, including its claims in connection with the Refining Company assets, were before this Court and subordinated by the opinion in the *Taylor* case (R. p. 1271; 306 U. S. 307). The evidence introduced at the hearings in January of 1940, although purporting to contradict the conclusions of this Court in the *Taylor* opinion (R. pp. 1296-1307), did not change the character of Standard's claim or the record originally before this Court. (R. p. 1271)[3]

[3]It is to be noted that Standard's contradictions of this Court's conclusions in the *Taylor* case are repeated in the instant petition (pp. 6, 11).

(b) Standard cannot be heard to contend that its subordinated claims and interests have value on the ground that the securities of certain of the holders of notes and preferred stock may have been purchased at depressed prices less than the full face amount.[4]

(c) All elements of value including the so-called "speculative resources" of Deep Rock and its record of earnings were necessarily considered by the District Court in reaching its conclusion as to the value of the Debtor's assets, which conclusion Standard does not challenge.

We shall not reargue the foregoing questions in this brief, but respectfully refer the Court to our positions in reference thereto as found in the briefs filed in Cause No. 465.

In addition to the contentions summarized above, Standard presents in the instant petition only one question (Pet. p. 7 pars. 1 and 2): since the Debtor is solvent and the plan provides for the prior rights of noteholders and for the participation of preferred stockholders, should the rule of absolute priorities be applied with the result that Standard, as a subordinated creditor and common stockholder, is excluded from participation without its consent. Standard contends that it cannot be eliminated and urges that "relative priorities" only should be maintained, as between it and the preferred stockholders. (Pet. p. 26)

It is our position that the rule of absolute priorities applies to determine the respective rights of the preferred stockholders, Standard (as a creditor subordinated to such

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[4]That the assignee of a claim is entitled, in the absence of fraud, to assert such claim for the full amount irrespective of the consideration which he may have paid for it, is supported by all of the authorities. See determination by Circuit Court of Appeals and cases there cited, R. pp. 1694-1695; our brief filed in Cause No. 465, pp. 8-9; brief of Securities and Exchange Commission filed in Cause No. 465, pp. 11-13.

rights) and common stockholders, and therefore requires Standard's elimination.[5]

In *Case* v. *Los Angeles Lumber Products Company, Ltd.*, 308 U. S. 106 (1939), this Court held that the statutory requirement that all plans of reorganization must be found to be "fair and equitable" included the fixed principle of *Northern Pacific Railway Company* v. *Boyd*, 228 U. S. 482 (1913), that is, the rule of absolute priorities. Recently, in *Consolidated Rock Products Co.* v. *du Bois*, ... U. S. ..... (October Term, 1940, Nos. 400 and 444), this Court held that this rule "applied to reorganizations of solvent as well as insolvent companies" and that the "rule was not satisfied even though the 'relative priorities' of creditors and stockholders were maintained."

No qualification or limitation is made by the statute in its requirement that all plans must be fair and equitable. If it is not "fair and equitable" to permit participation by stockholders when the rights of creditors are not satisfied in full, it is equally unfair to include common stockholders when the prior rights of preferred stockholders are not satisfied. Where, as here, the value of a debtor's assets has been found to be more than the claims of the creditors but substantially less than the aggregate claims and interests of the creditors and preferred stockholders, no plan can be fair and equitable which provides for participation by any interests subordinate to the preferred stock.

If Standard were permitted to participate in a reorganization plan under such conditions, this Court's decree of subordination would be nullified. If Standard were to re-

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[5]Surely the rule cannot be relaxed in favor of Standard, whose claim was subordinated to the interests of the holders of preferred stock, as stated by this Court in *Pepper* v. *Litton*, 60 S. Ct. 238, 246; 308 U. S. 295 (1939) because of "the history of spoliation, mismanagement and faithless stewardship of the affairs of the subsidiary by Standard to the detriment of the public investors."

ceive securities for its worthless interest, value would thereby be taken and diverted from the senior classes. This would not be subordination. Subordination means participation after, and only after, prior claims have been satisfied in full.

Standard suggests (Pet. pp. 22, 23) that the Debtor's corporate charter gives to it as a common stockholder a contract right to participate so long as any equity exists for the preferred stock, unless and until actual liquidation is enforced. This argument misconceives the nature of the contract right and the purposes of the reorganization statutes. The statutes provide a modern alternative for liquidation with its consequent sacrifice sale, by permitting continued business operation and retaining going concern values for fair allocation under reorganization plans among all classes shown on the basis of such values to have an interest. Where an appraisal of the value of the debtor's assets as a going concern shows that junior securities of either creditors or stockholders or both are worthless, all "interests" of such classes thereby disappear. (*In re 620 Church Street Building Corporation,* 299 U. S. 24 (1936))

It is urged in the petition (pp. 26, 27) that the application of the rule of absolute priorities as between classes of stockholders discourages investment in common stocks and thereby conflicts with desirable social and economic objectives. Such application, however, no more discourages investment in equities than the application of the rule as between creditors and stockholders. The rule by its uniform application in both situations serves the greater social and economic objective of insuring fairness by the protection in full of the interests of each class of creditors and stockholders in the order of their respective priorities.

Standard finally asserts that as the holder of common stock and as a subordinated creditor it is affected by the

Plan within the meaning of Section 216 of Chapter X of the Bankruptcy Act, as amended, and that therefore the Plan cannot be confirmed without its consent unless the provisions of Section 216(7) and (8) providing methods for the protection of non-assenting affected classes of creditors and stockholders are followed. Section 216(7) and (8) provide that any class of creditors or stockholders affected by a plan and who do not accept it must be provided "adequate protection" for the realization by them of the value of their claims (in the case of creditors) and of their equity, if any (in the case of stockholders), by one of the methods prescribed by the statute.

Section 107 of Chapter X defines persons affected by a plan as follows:

> "Creditors or stockholders or any class thereof shall be deemed to be 'affected' by a plan only if their or its interest shall be materially and adversely affected thereby."

Since Standard's claims and common stock interests have been determined to be valueless, it has no interest to be affected by the Plan.

This Court in *In re 620 Church Street Building Corporation,* 299 U. S. 24 (1936), held that the valueless junior interests there involved were not affected by the plan; that a valuation, of which no complaint was made, accorded such interests adequate protection; and that the finding that there was no equity for them was a finding that they, in fact, held no property of which they could be deprived.[6]

It seems mere sophistry to insist that Standard as a subordinated creditor and common stockholder, where its in-

[6]In a footnote to the opinion in *Case* v. *Los Angeles Lumber Products Company, Ltd.,* 308 U. S. 106, 120 (1939), this Court cited its opinion in the *Church Street* case following the statement "But under § 77B approval of a plan by security holders who have no equity in the enterprise is unnecessary."

terests are valueless, must either consent to a Plan eliminating such interests or that the Plan must provide for the protection of such non-existent interests.

The elimination of worthless classes of either creditors or stockholders is merely incidental to and in aid of the ultimate and principal purposes of the statute. The authorities are uniform in holding that under the reorganization statutes a court of bankruptcy may properly eliminate classes of stockholders having no equity even though the corporation may be solvent and other prior classes of stockholders are allowed participation.

In re Utilities Power & Light Corporation, 29 F. Supp. 763, 769 (D. C. N. D. Ill., 1939), app. dis. 7 Cir. C. C. A. on March 9, 1940, without opinion, Causes Nos. 7221, 7222.[7]

In re National Food Products Corporation, 23 F. Supp. 979 (D. C. Md., 1938).

Continental Insurance Co. v. *Louisiana Oil Refining Corporation,* 89 F. (2d) 333, 338 (C. C. A. 5th, 1937).

In re Chicago, Great Western Railroad Company, 29 F. Supp. 149 (D. C. N. D. Ill., 1939).

Finletter's Bankruptcy Reorganization (1939), p. 417.

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[7]In the footnote on pages 23-24 of its petition Standard concedes that "the point discussed in the text of this brief" was involved in the appeal in the *Utilities Power and Light* case, but urges that the action of the Circuit Court of Appeals in dismissing the appeal "casts no light on the question discussed in the text." The question however was definitively decided by the District Court (29 F. Supp. 763, 769) and the appeal could not have been dismissed if the Circuit Court of Appeals agreed with the proposition here advanced that a common stockholder must participate in any reorganization "where there is any equity for stockholders of any class" (Pet., p. 23).

Moore's Bankruptcy Manual (1939), p. 575.

Gerdes, Corporate Reorganizations, Vol. 2, p. 1726 (1936).

53 *Harvard Law Review* 713 (March, 1940).

34 *Illinois Law Review* 589 (January, 1940).

There is no authority to the contrary in any decided case. Standard cites (Pet. pp. 10, 24) only one decision in a reorganization case, *Campbell* v. *Alleghany Corporation,* 75 F. (2d) 947 (C. C. A. 4th, 1935), cert. den. 296 U. S. 581. The holding in this case has no possible bearing here. The opinion, however, recognizes that a plan of reorganization does not affect claims which are admittedly worthless on an uncontested appraisal. There is no conflict between the decision of the Fourth Circuit in the *Campbell* case and that of the Circuit Court of Appeals for the Tenth Circuit in the orders here sought to be reviewed.

CONCLUSION

This proceeding has been before the courts since February of 1933. It does not now involve any substantial undetermined questions of law. In accordance with this Court's opinion in the *Taylor* case, Standard's asserted right to participate in the reorganization was adjudicated adversely to it by the District Court in the order entered February 29, 1940, and by the Circuit Court of Appeals for the Tenth Circuit, which affirmed that order on June 29, 1940 (113 F. (2d) 266, cert. den. Cause No. 465 November 12, 1940). The orders of the courts below approving and confirming the Plan of Reorganization which excluded Standard from participation were inevitable under the prior decisions of this Court and raise no new issues of importance.

We respectfully submit that the discretion of this Court should be exercised to deny the petition for writs of cer-

tiorari and thereby at last bring to fruition the long sustained efforts of the parties in interest to achieve a constructive result.

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INDEX

	Page
Opinion below	2
Jurisdiction	2
Questions presented	2
Statute involved	3
Statement	3
Argument	5
Conclusion	11
Appendix	12

CITATIONS

Cases:	
Case v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106	7
Campbell v. *Alleghany Corporation*, 75 F. (2d) 947	11
Chicago Great Western Ry. Co., In re, 29 F. Supp. 149	8, 10
Consolidated Rock Products Co. v. *Du Bois*, Nos. 400 and 444, present Term, decided March 3, 1941	8, 9
Consolidation Coal Co., In re, 11 F. Supp. 594	10
Continental Insurance Co. v. *Louisiana Oil Refining Co.*, 89 F. (2d) 333	8
National Food Products Corp., In re, 23 F. Supp. 979	8, 10
Nebel Co., Inc., Oscar, In re, unreported decision July 11, 1940, No. 7394 (C. C. A. 3d)	10
620 Church Street Bldg. Corp., In re, 299 U. S. 24	7, 8
Taylor v. *Standard Gas & Electric Co.*, 306 U. S. 307	3, 4
Utilities Power & Light Corp., In re, 29 F. Supp. 763, appeal dismissed C. C. A. 7th, March 9, 1940	8, 10
Witherbee Court Corp., In re, 88 F. (2d) 251, certiorari denied, *sub nom. Klee Corp.* v. *Roosevelt*, 301 U. S. 701, rehearing denied, 301 U. S. 715	8
Statute:	
Bankruptcy Act, Act of July 1, 1898, c. 541, 30 Stat. 544, as amended (11 U. S. C. § 1 *et seq.*):	
Sec. 107 (11 U. S. C. § 507)	6, 12
Sec. 174 (11 U. S. C. § 574)	12
Sec. 179 (11 U. S. C. § 579)	5, 12
Sec. 216 (7), (8) (11 U. S. C. § 616)	6, 13, 14
Sec. 221 (2) (11 U. S. C. § 621)	14
Miscellaneous:	
Finletter, *The Law of Bankruptcy Reorganization* (1939) pp. 417–418	8, 10
Gerdes, Corporate Reorganizations (1936), Vol. 2, p. 1740	8, 10

In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 846

STANDARD GAS AND ELECTRIC COMPANY, PETITIONER

v.

DEEP ROCK OIL CORPORATION, DEBTOR, HENRY N. GREIS, TRUSTEE, JOHN J. SHINNERS, ET AL.

No. 847

STANDARD GAS AND ELECTRIC COMPANY, PETITIONER

v.

DEEP ROCK OIL CORPORATION, DEBTOR, HENRY N. GREIS, TRUSTEE, JOHN J. SHINNERS, ET AL.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

The Securities and Exchange Commission is participating in these reorganization proceedings with the approval of the District Judge, pursuant to the provisions of Sections 208 and 276c (2) of Chapter X of the Bankruptcy Act, as amended, c. 575,

52 Stat. 894, 905 (11 U. S. C., §§ 608, 676 (c) (2)) and is an appellee on this appeal (see Rule 73 (b) of the Rules of Civil Procedure).

OPINION BELOW

The opinion of the Circuit Court of Appeals for the Tenth Circuit (R. 1686) is not yet reported. The order of the District Court approving the plan of reorganization (R. 1385) and the order confirming the plan of reorganization (R. 1399) are not reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 13, 1941 (R. 1695). The petition for writs of certiorari was filed on March 14, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. May petitioner's claims or interests ranking junior to preferred stock be excluded from participation in a plan of reorganization where the debtor, although solvent, has assets of a value less than the prior claims and interests of creditors and preferred stockholders?

2. Are the facts and circumstances of this reorganization such as to render inapplicable the rule of absolute priority?

STATUTE INVOLVED

The pertinent provisions of the Bankruptcy Act appear in the Appendix, *infra*, pp. 12–14.

STATEMENT

The present controversy arises in the same reorganization proceeding which was before this Court in *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307 (hereinafter referred to as the *Taylor* case), and on the petition for a writ of certiorari filed by Standard Gas and Electric Company (hereinafter referred to as "Standard") on September 26, 1940, No. 465, present Term, which was denied by this Court on November 12, 1940.[1]

After the decision of this Court in the *Taylor* case that Standard's claims must be subordinated to the interests of the preferred stockholders, the Reorganization Committee filed an amended plan of reorganization. Since the senior claims and interests of the noteholders and preferred stockholders exceeded in amount the value of the debtor's assets,[2] the plan provided for no participation for Standard's subordinated claims. Shortly thereafter Standard filed an "amended" claim (R. 91) which involved no new items (R. 1271). A hearing on that claim and on the plan of reorganization was held on January 29 and 30, 1940, before the District Court (R. 1184).

On February 29, 1940, the District Court found that the value of the assets of the debtor was less

[1] The record in No. 465 has been incorporated as Vols. I and II of the record in these cases.

[2] The valuation upon which this Court and the lower courts have predicated all their opinions is unchallenged by Standard in this proceeding.

than the claims of the debtor's noteholders for principal and interest and the liquidation preference of the 50,000 shares of the debtor's preferred stock. Since, under the decision of this Court in the *Taylor* case, Standard's claims of whatever nature were required to be subordinated to the senior claims of the noteholders and the interests of the preferred stockholders, the court found that Standard's claims were of no value and accordingly that Standard was not entitled to participate in the reorganization (R. 148, 159).[3] The Circuit Court of Appeals affirmed the decision of the District Court,[4] and Standard's petition to this Court for a writ of certiorari was denied.[5]

Having disposed of Standard's claim, the District Court, on May 28, 1940, approved the Reorganization Committee's amended plan of reorganization and confirmed it on July 24, 1940. Standard appealed from the orders of approval and confirmation and the appeals were consolidated. The Circuit Court of Appeals affirmed (R. 1695–1696), stating:

> In its order of February 29, 1940, and again in its order of July 24, 1940, the trial court expressly found that the assets of the

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[3] Standard owns a small amount of preferred stock which was not excluded. Standard argued below, but does not argue here, that the plan is unfair to it as a preferred stockholder.

[4] 113 F. (2d) 266 (R. 1372).

[5] No. 465, this Term, decided November 12, 1940.

debtor were not sufficient in value to satisfy in full the claims of the noteholders and the preferred stockholders. It follows under our holding In re Deep Rock Oil Corporation, 113 F. (2d) 266, Standard is not entitled to participate (R. 1690–1691).

ARGUMENT

The present petition is in effect an attempt to secure review by this Court of questions which this Court refused to review when it denied Standard's earlier petition for certiorari, No. 465, present Term. The grounds advanced for issuance of the writs in the present petition are restatements of questions presented or necessarily involved in the earlier petition. Consequently, we refer to our brief in opposition in No. 465 for a statement of the Commission's position on the propriety of the exclusion of Standard from participation in the reorganization plan. There are certain arguments now made, however, which are cast in somewhat different form than in the earlier petition, or which express views which were only implicit in that petition. These arguments require brief additional comment.

1. Standard contends that the prerequisites for confirmation of a plan provided by Section 179 of the Bankruptcy Act have not been satisfied because under that section either Standard's consent to the plan must be obtained or some provision must be made for the protection of its interests. Section 179 provides that the plan must be accepted by or

on behalf of creditors holding two-thirds in amount of the claims filed and allowed for each class, and, if the debtor has not been found to be insolvent, by or on behalf of stockholders holding a majority of the stock of each class, exclusive of creditors and stockholders who are not affected by the plan or for whom payment or protection has been provided as prescribed in paragraphs (7) and (8) of Section 216. Section 216 (7) requires that the plan "shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims * * *." Section 216 (8) requires that the plan "shall provide for any class of stockholders which is affected by the plan and does not accept the plan by the majority of the stock required under this chapter, adequate protection for the realization by them of the value of their equity, *if any,* in the property of the debtor dealt with by the plan * * *." [Italics added.] Section 107 provides that "Creditors or stockholders or any class thereof shall be deemed to be 'affected' by a plan only if their or its interest shall be materially and adversely affected thereby."

Read together, these sections require that where a class of security holders has an interest to be protected, acceptances by the requisite percentage

of the class must be obtained; or in the absence of such acceptances, adequate protection must be provided for its claims or interests in some other manner. But where the class has no remaining interest to be protected, that class is not affected by the plan within the meaning of these provisions and, accordingly, no acceptance by that class is required and no other protection need be afforded to it. In *In re 620 Church Street Bldg. Corp.*, 299 U. S. 24, 27, this Court so interpreted a similar provision in Section 77B upon objection of excluded junior creditors and stockholders, stating:

> Petitioners insist that their consent to the plan of reorganization was necessary or that their claims should have been accorded "adequate protection." But the adequate protection to which the statute refers is "for the realization of the value of the interests, claims or liens" affected. Here the controlling finding is not only that there was no equity in the property above the first mortgage but that petitioners' claims were appraised by the court as having "no value." There was no value to be protected. This finding embraces whatever interests petitioners may have as junior lienors under the Illinois law and, in the same aspect, the constitutional argument is unavailing as petitioners have not shown injury.[6]

[6] In *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106 (footnote, p. 120), the Court stated, "But under

Standard attempts to distinguish that decision on the ground that the debtor in that case was insolvent (Pet. 9, 21). But the criterion for protection of non-assenting classes of security holders is the same whether there be solvency or insolvency, namely, whether the class has an interest in the assets of the debtor. The lower courts have uniformly held that the rationale of this Court in *In re 620 Church Street Bldg. Corp., supra,* is applicable with respect to excluded classes of stockholders in the reorganization of solvent debtors.[7]

2. Standard also contends that it is unfair and illegal to exclude its claim and stock from participation under the plan because the debtor is solvent. An attempt is made to distinguish the recent decision of this Court in *Consolidated Rock Products Co.* v. *DuBois,* Nos. 400 and 444, present Term, decided March 3, 1941, on the ground that the

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§ 77B approval of a plan by security holders who have no equity in the enterprise is unnecessary." See also *In re Witherbee Court Corp.*, 88 F. (2d) 251 (C. C. A. 2d), certiorari denied, *sub nom. Klee Corp.* v. *Roosevelt*, 301 U. S. 701, rehearing denied, 301 U. S. 715.

[7] *In re National Food Products Corp.*, 23 F. Supp. 979 (D. Md.); *In re Utilities Power & Light Corp.*, 29 F. Supp. 763 (N. D. Ill.), appeal dismissed, C. C. A. 7th, March 9, 1940; *cf. Continental Insurance Co.* v. *Louisiana Oil Refining Co.*, 89 F. (2d) 333, 338 (C. C. A. 5th). For a similar holding with respect to Section 77, which has substantially the same provisions, see *In re Chicago Great Western Ry. Co.*, 29 F. Supp. 149, 157 (N. D. Ill.). See also *Gerdes, Corporate Reorganizations* (1936), Vol. 2, p. 1740; Finletter, *The Law of Bankruptcy Reorganization* (1939), pp. 417–418.

issue there was between creditors and stockholders. But in the *Consolidated Rock Products* case, the Court indicated that the absolute priority rule was applicable as between classes of stockholders, stating (footnote 27):

> It should, however, be noted as respects the warrants issued to the old common stockholders that they admittedly have no equity in the enterprise. Accordingly, it should have been shown that there was a necessity of seeking new money from them and that the participation accorded them was not more than reasonably equivalent to their contribution.

Moreover, the distinction is based on a misconception of the principle involved. Participation of a class of security holders under a fair plan is always dependent on the existence of an equity for that class. Any other test would result in the taking of the property of a senior class for the benefit of a junior class. That principle is as applicable to classes of stock of different rank as it is to other types of securities.

Standard argues that the contract between the preferred and common stockholders so differs from the contract between creditors and stockholders as to require the application of different standards of fairness. It contends that the prior rights of the preferred stockholders to payment arise only on liquidation, that a reorganization is not a liquidation, and hence that the preferred stockholders are not entitled to a recognition of

their liquidating preference in a reorganization, to the exclusion of the common stock. But this misconceives the principles underlying the reorganization process. Under the reorganization technique of the Bankruptcy Act, the security holders receive, as the proceeds of their claims, interests in the reorganized enterprise in lieu of the cash or other proceeds which would result from a forced sale. But this affords no ground for disregarding the priorities of the respective classes of creditors and stockholders, which determine the order in which these interests shall share in the going-concern values. With respect to priorities, the principle underlying the distribution of the proceeds is the same whether the distribution is of the proceeds of liquidation or of the proceeds of reorganization.

The liquidation preferences of preferred stockholders have been uniformly adopted by the lower courts as the measure of priority in a reorganization, and securities junior thereto with no remaining equity have been excluded from participation.[8] Under the rule of these cases, since the assets of the debtor here are admittedly insufficient to accord the preferred stockholders fully compensatory

[8] *In re Utilities Power & Light Corp.*, *supra*; *In re Oscar Nebel Co., Inc.*, unreported decision July 11, 1940, No. 7394 (C. C. A. 3d); *In re National Food Products Corp.*, *supra*; *In re Consolidation Coal Co.*, 11 F. Supp. 594 (D. Md.); *In re Chicago Great Western Ry. Co.*, *supra*. See also *Gerdes, Corporate Reorganizations* (1936), *supra*; Finletter, *The Law of Bankruptcy Reorganization* (1939), *supra*.

treatment under the plan of reorganization, Standard's subordinate claims and interests are entitled to no participation.

Campbell v. *Alleghany Corporation,* 75 F. (2d) 947 (C. C. A. 4th), cited by Standard as being in conflict with the decision below, is obviously not in point. The court there, declaring Section 77B to be constitutional insofar as it affects the rights of stockholders, pointed out that when the corporation is solvent the plan "must be accepted by the holders of a majority of the stock *affected.*" [Italics added.] It does not appear that in the *Campbell* case the corporation had more than one class of stock, so the point here involved was clearly not there before the court.

CONCLUSION

The petition for writs of certiorari should be denied.

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APRIL 1941.

APPENDIX

Relevant sections of the Bankruptcy Act, Act of July 1, 1898, c. 541, 30 Stat. 544, as amended (11 U. S. C., § 1 *et seq.*):

Sec. 107 (11 U. S. C., Supp. V, § 507): Creditors or stockholders or any class thereof shall be deemed to be "affected" by a plan only if their or its interest shall be materially and adversely affected thereby. In the event of controversy, the court shall after hearing upon notice summarily determine whether any creditor or stockholder or class is so affected.

Sec. 174 (11 U. S. C., Supp. V, § 574): After the hearing, as provided in section 169 or section 170 of this Act, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in section 172 of this Act, then after the filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply with the provisions of section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a time within which the creditors and stockholders affected thereby may accept the same.

Sec. 179 (11 U. S. C., Supp. V, § 579): After a plan has been accepted in writing, filed in court, by or on behalf of creditors holding two-thirds in amount of the claims

filed and allowed of each class, and, if the debtor has not been found to be insolvent, by or on behalf of stockholders holding the majority of stock, of which proofs have been filed and allowed, of each class, exclusive of creditors or stockholders or of any class of them who are not affected by the plan or whose claims or stock are disqualified pursuant to section 203 of this Act, or for whom payment or protection has been provided as prescribed in paragraphs (7) and (8) of section 216 of this Act, the judge shall fix a hearing, upon notice to the debtor, creditors, stockholders, indenture trustees, the Secretary of the Treasury, the Securities and Exchange Commission, and such other persons as the judge may designate, for the consideration of the confirmation of the plan and of such objections as may be made to the confirmation.

Sec. 216 (11 U. S. C., Supp. V, § 616): A plan of reorganization under this chapter—

* * * * *

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of

such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

(8) shall provide for any class of stockholders which is affected by the plan and does not accept the plan by the majority of the stock required under this chapter, adequate protection for the realization by them of the value of their equity, if any, in the property of the debtor dealt with by the plan, either as provided in the plan or in the order confirming the plan, (a) by the sale of such property at not less than a fair upset price; or (b) by appraisal and payment in cash of the value of their stock; or (c) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection: *Provided, however,* That such protection shall not be required if the judge shall determine that the debtor is insolvent;

* * * * *

Sec. 221 (11 U. S. C., Supp. V, § 621): The judge shall confirm a plan if satisfied that—

* * * * *

(2) the plan is fair and equitable, and feasible;

* * * * *

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